

**AMERICAN STORES COMPANY**

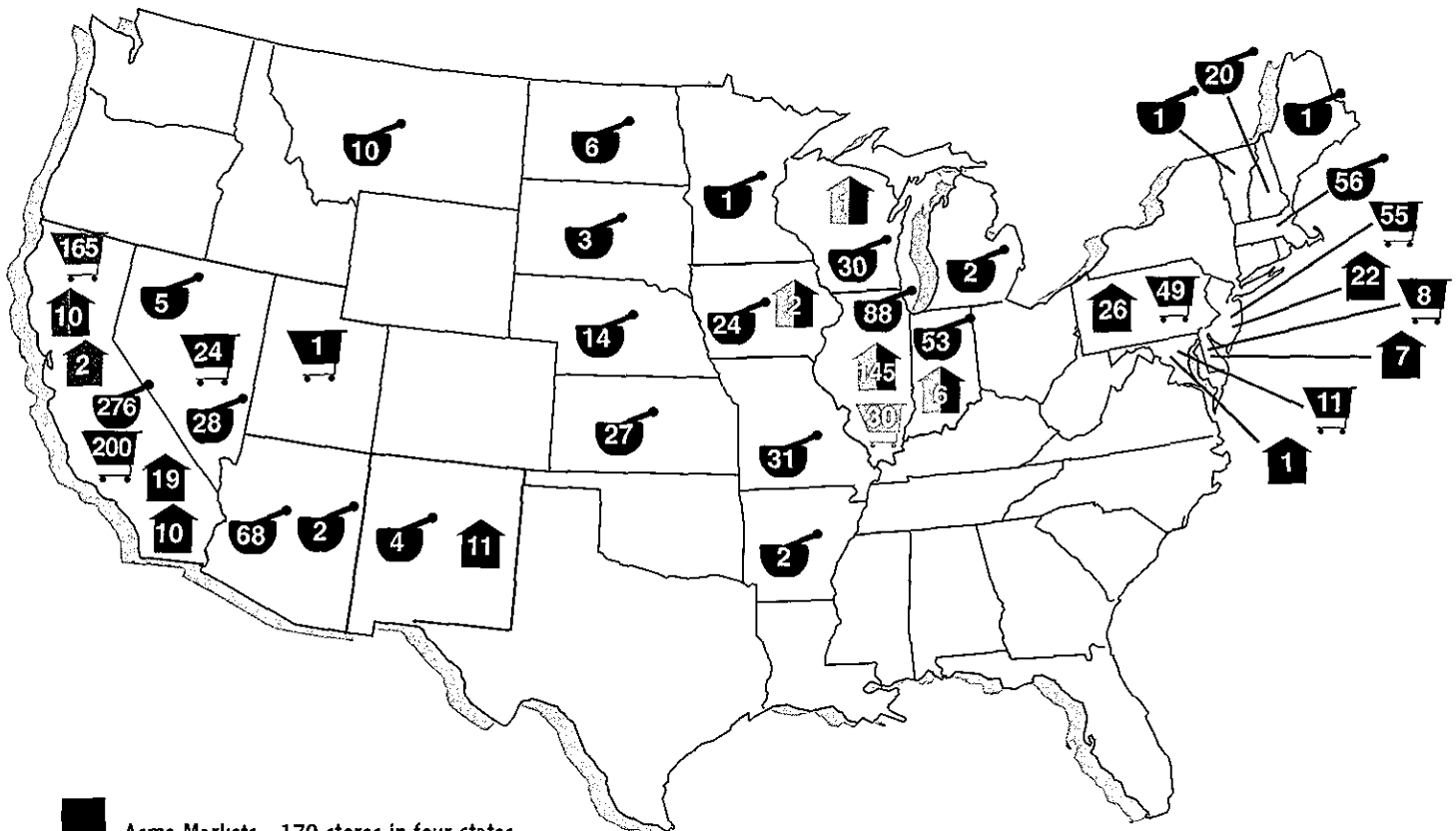
*1997 Annual Report*

## COMPANY PROFILE



American Stores Company is one of the nation's leading food and drug retailers operating supermarkets, stand-alone drug stores and combination food/drug store units. The Company's stores are generally located in major metropolitan markets where they hold leading market positions (generally first or second in overall market share). The Company's stores operate under the names Acme Markets, Jewel Food Stores, Lucky Stores, Osco Drug and Sav-on. At year-end 1997, the Company operated 1,557 stores in 26 states and employed approximately 121,000 associates.

**ACME**™ **Lucky**® **Sav-on drugs**™ **Osco Drug**® **Jewel-Osco**®



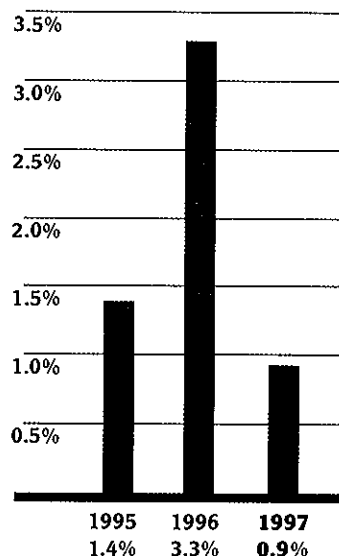
- Acme Markets - 179 stores in four states
- Jewel Food Stores - 184 stores in four states including 154 combination stores jointly operated with Osco Drug
- Lucky Stores Northern California Division - 177 stores in one state including 10 combination stores jointly operated with Sav-on
- Lucky Stores Southern California Division - 265 stores in four states including 30 combination stores jointly operated with Sav-on
- Osco Drug - 442 stand-alone drug stores in 19 states plus 154 combination stores jointly operated with Jewel Food Stores
- Sav-on - 310 stand-alone drug stores in four states plus 40 combination stores jointly operated with Lucky Northern and Southern California Divisions

- 543 Supermarkets
- 752 Stand-alone Drug Stores
- 262 Combination Stores

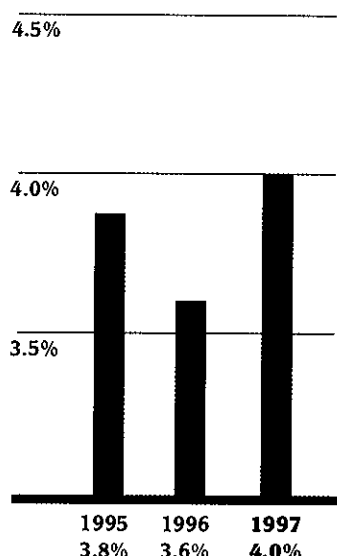
The mission of American Stores Company is to be the premier, national food and drug retailer that understands and surpasses its customers' expectations for service, value, and convenience. Our success is directly dependent on our people who must work together as associates to fulfill this mission.



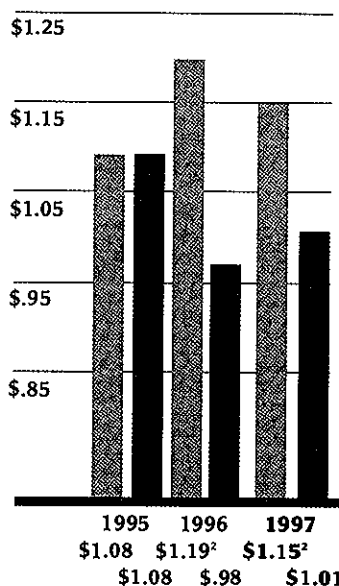
## Comparable Store Sales % change



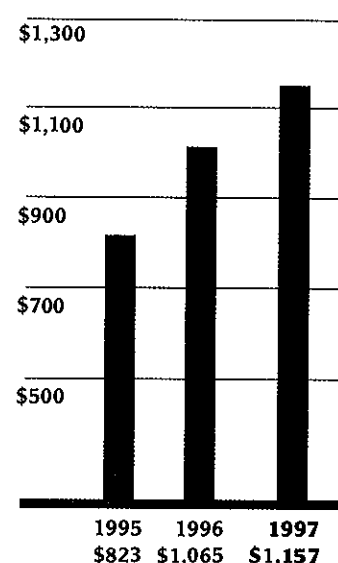
## Operating Profit Percent of Sales



## Diluted Earnings Per Share<sup>1</sup>



## Capital Expenditures \$ in millions



<sup>1</sup> 1995 was a 53-week year

<sup>2</sup> Includes non-recurring items totaling \$.21 and \$.14 per diluted share of expense for 1996 and 1997, respectively

## COMMON STOCK MARKET PRICES AND DIVIDENDS<sup>3</sup>

The following table sets forth the high and low reported sales prices for the Company's common stock for the fiscal periods indicated as reported on the New York Stock Exchange Composite Tape and dividends paid on the common stock during such periods. The common stock of the Company is listed on the New York, Philadelphia, Chicago and Pacific stock exchanges under the trading symbol "ASC." The number of shareholders of record of the Company's common stock at March 27, 1998, was 33,715.

	1997			1996			1995		
	Market Price High	Market Price Low	Cash Dividends Paid	Market Price High	Market Price Low	Cash Dividends Paid	Market Price High	Market Price Low	Cash Dividends Paid
First Quarter	\$23 3/16	\$20 13/16	\$.08	\$17 1/8	\$12 11/16	\$.08	\$13 1/16	\$11 5/8	\$.07
Second Quarter	\$27 5/16	\$22	.09	\$20 5/8	\$16	.08	\$14 7/8	\$12 3/8	.07
Third Quarter	\$26	\$23	.09	\$21 3/8	\$18 3/4	.08	\$15 3/8	\$14 1/16	.07
Fourth Quarter	\$28	\$19 3/8	.09	\$22 11/16	\$19 3/16	.08	\$15 3/8	\$12 7/16	.07
Annual Dividend			<u>\$.35</u>			<u>\$.32</u>			<u>\$.28</u>

<sup>3</sup> Restated as necessary to reflect the July 1997 two-for-one stock split

## Cautionary Note

This report contains certain forward-looking statements about the future performance of the Company which are based on management's assumptions and beliefs in light of the information currently available to it. The Company assumes no obligation to update the information contained herein. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements including, but not limited to: competitive practices and pricing in the food and drug industry generally and particularly in the Company's principal markets; the implementation of the Company's re-engineering initiatives in accordance with the currently contemplated schedule and budget; the Company's relationships with its employees and the terms of future collective bargaining agreements; the costs and other effects of legal and administrative cases and proceedings; the nature and extent of continued consolidation in the food and drug industry; changes in the financial markets which may affect the Company's cost of capital and the ability of the Company to access the public debt and equity markets to refinance indebtedness and fund the Company's capital expenditure program on satisfactory terms; supply or quality control problems with the Company's vendors; changes in economic conditions which affect the buying patterns of the Company's customers; and the ability of the Company and its vendors, financial institutions and others to resolve Year 2000 processing issues in a timely manner.

**To Our Shareholders:**

Over the past four years our Company has grown and matured into an operating company whose top priority is customer satisfaction. Our management and associate teams, technological systems and store designs all revolve around our goal of being the premier, national food and drug retailer focused on serving our customers. With our consolidated infrastructure and central management group, we are successfully fine-tuning our ability to serve what really matters to our future: our customers. This is not how it has always been.

Five years ago, the purpose of our small team of American Stores corporate managers was to oversee a collection of fully autonomous food and drug retail chains. We would buy and sell entire chains as a holding company without becoming involved in improving the operations. I am proud to say that today this is no longer the way we manage our Company. After years of hard work, we have transformed ourselves from a decentralized holding company to a centralized operating company. I am proud of this accomplishment and I would like to thank every one of our dedicated associates for making it happen.

During the year we completed the centralization of our procurement functions and made excellent progress in implementing several new store and supply-chain information systems. Our store growth program also moved ahead as we invested nearly \$1.2 billion in capital expenditures and added 96 new or replacement stores to bring our store count at year-end to 1,557.

The changes to our organization this year were tremendous and affected nearly every area of our business. Changes of such size and ambition do not come without challenges. We experienced difficulty in some areas of our transition during the year, but have put those issues behind us and are a stronger company as a result. We are pleased with the success of our dramatic transformation over the years. We achieved many victories, and our struggles were few overall.

Moving forward, we will continue to execute our strategy of growth by investing in our stores and allowing our associates to better serve our customers. We are committed to this strategy and believe it is right for our business. Our capital expenditures for 1998 are estimated to be \$1 billion, and we will add 70 to 80 new stores. Our technology initiatives will continue to strengthen our infrastructure and position us for the next century. We have just begun to organize a central marketing team to develop and implement the most effective marketing, advertising and promotional strategies on a Company-wide basis. We believe we have laid a solid foundation in our store base, distribution and support structure, and will reap the benefits of those investments in the years ahead.

Respectfully,

Victor L. Lund  
Chairman and Chief Executive Officer  
April 1998



## Focus on our Food and Drug Customers

The mission of American Stores Company is to be the premier, national food and drug retailer. To distinguish our stores from the many forms of competition we face today, we strive to identify customer needs and preferences, and provide attractive, modern stores and merchandise to meet and exceed our customers' expectations. We know our customers want value, quality and convenience. We know they want a broad selection of food, general merchandise and pharmacy in one stop. We also know they insist on fresh, quality produce. Many customers also desire quality, ready-to-eat prepared meals. We build and operate our food stores to be responsive to these demands. Driving sales and retaining and growing our market share through attention to our shoppers is key to our sustained long-term growth.



Today's drug store customers expect convenience and shopping ease. Pharmacy will continue to be the driver of drug store sales and drug retailers will have to be responsive to customer prescription needs. Our drug store customers expect quick access to their prescriptions, minimum wait times and accuracy in filling prescriptions. They also expect constructive interaction with our pharmacists and convenient prescription ordering and pick-up. Store size, layout, technology, drive-up access and location are key to meeting these needs.

For American Stores, one of our competitive advantages is our combination stores. These stores combine a complete food store with a full drug store under one roof, with a common front-end checkout. A combination store is most effective when it

includes the separate identities of our existing food and drug chains - like Jewel Osco and Lucky Sav-on. This combination succeeds in driving cross-over sales between the two sides and presents significant opportunities for synergy in operating costs, marketing, merchandising, distribution and administration. In addition, in markets where we operate stand-alone drug stores and combination stores, we have a pharmacy network that is currently unmatched by other supermarket pharmacy operations.

An additional strength of our pharmacy operations network is RxAmerica, a pharmacy benefits management company and prescription mail-order operation. RxAmerica, a joint venture with Longs Drug Stores, contracts with insurance companies and health plans to administer pharmacy benefits and to offer their participants a strong retail pharmacy network. The joint venture provides an effective means of competing for important third-party prescription business.

**"The new Lucky Sav-on store is beautiful. The selection, layout, presentation and perishables are much better than the older Lucky that this one replaced. It is also very convenient having a whole Sav-on right in the same store as the Lucky."**

**- Penny Hoover**



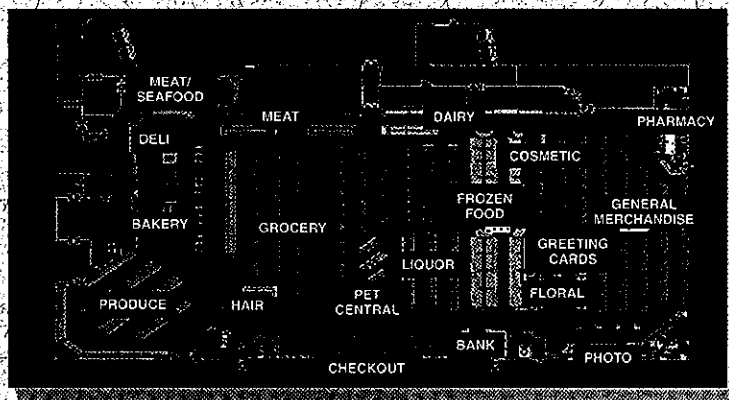




## Customer-Friendly Store Formats...

The diagram to the right shows how we configure our new combination stores. As you can see, we offer many departments including grocery, produce, deli, meat, seafood, dairy, frozen food and bakery. Our new stores offer meal solutions of both hot and chilled prepared foods. On the drug side, we offer a full drug store with general merchandise, seasonal products, greeting cards, photo-finishing, health and beauty aids, liquor, over-the-counter drugs, vitamins, and of course, pharmacy. Additional customer services may include a full-service bank, video rental or dry-cleaner. The combination stores we build today are about 65,000 square feet and offer approximately 50,000 different products. Our jointly operated combination stores grow sales much faster and generate higher sales volumes than their traditional supermarket and stand-alone drug store counterparts.

## Combination Store



## Free-Standing Drug Store



We also know the convenience of a stand-alone drug store is important to our customers. This diagram shows how we build our drug stores today. We have the same drug store category offerings as in the combination store, but this store is much smaller, about 16,500 square feet with about 30,000 products. We seek sites that are free-standing locations, not strip centers, so we can provide convenient access, parking and a drive-up pharmacy window whenever possible. Many of our drug stores also offer a food mart and Health 'n' Home home health care aisles to supplement the general merchandise business. We have 24 Health 'n' Home centers within Osco and Sav-on drug stores in

addition to six durable medical equipment distribution centers that offer home delivery of items such as oxygen concentrators, wheelchairs, hospital beds and infusion therapy equipment.

Our capital expenditures were \$1.157 billion in 1997. We opened or acquired 33 new combination stores, 7 supermarkets and 56 stand-alone drug stores. While we do not remodel nearly as many stores as we used to, we completed 65 store remodels this year and our net square footage expansion was 4.2%.

"The new Jewel Osco in my neighborhood is so easy to shop and they have everything! The selection is great and I can get my groceries, prescriptions, all my make-up and even a hot meal when there's no time to cook."

- Gerri Smallwood





**... in Attractive Markets**

**ACME**

In the Philadelphia area, we operate Acme Markets. We have been repositioning this chain for four years by building larger, more modern stores. We currently operate 56 combination stores and plan to add about 10 more each year for the next four years.

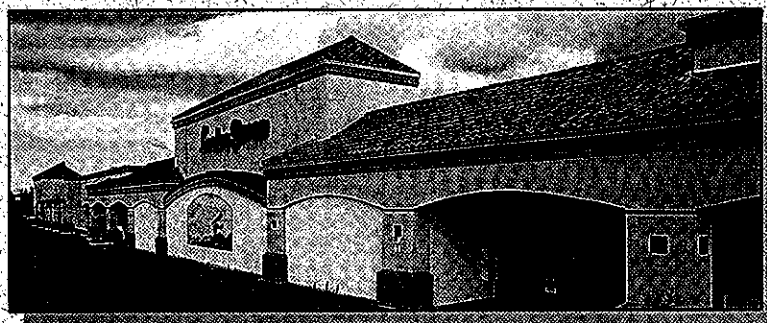


**Jewel-Osco**

Our Jewel Food Stores in the Chicago area operate primarily as Jewel-Osco combination stores. Our store base is growing with the greater Chicago market area. We recently expanded our Jewel-Osco stores to nearby Milwaukee, Wisconsin.

**Lucky**

We are rapidly expanding our network of Lucky, Sav-on stores in both southern and northern California. As of year-end we operated 40 of these stores in California and New Mexico and plan to open approximately 40 more over the next two years.



**Osco Drug**



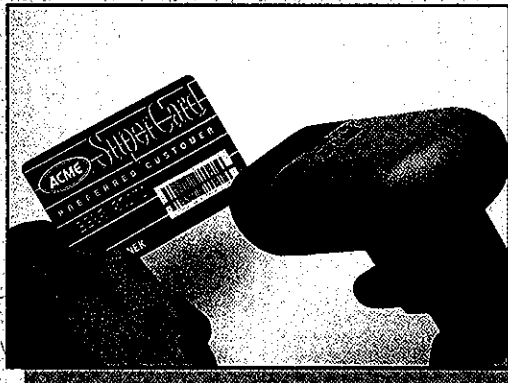
**Savon drugs**



We offer a broad pharmacy network consisting of over 1,100 pharmacies in stand-alone drug stores, combination stores and supermarkets. Osco and Sav-on stores are located in California, Chicago, New England and other areas in the Southwest and Midwest. In 1997 our pharmacy sales in comparable stores increased 11.5% over the prior year. Free-standing corner stores like those shown above are built around our combination store network to provide critical market density. This is important in growing pharmacy sales that are reimbursed through third-party insurance and health plans. During 1997 American Drug Store pharmacies filled approximately 80 million prescriptions.



## Building Customer Loyalty



We strive to develop strong relationships with our customers to keep them loyal to our stores. One way we accomplish this is through our customer loyalty card program. Most of our stores offer loyalty cards that entitle the holders to added savings, automatic coupon discounts, free items, prizes and more. We now have approximately 20 million cards in circulation nationwide, and over 80% of our supermarket and combination store sales are to cardholders. We have been a leader in executing our card program and believe we have the most extensive and sophisticated card system in the industry.

The customer shopping information we obtain through the cards allows us to tailor our advertising efforts based on our

customers' preferences. We analyze the shopping patterns and purchasing statistics so we can market to specific customer needs. Our new Revelar decision support system was developed internally at American Stores and allows us to use the data efficiently in formulating customer-specific marketing plans. This ability is particularly useful in our combination stores. For example, we can identify customers that are currently only shopping one side of the store. If a group of customers is buying primarily food products, we can tailor direct-mail marketing that introduces them to our general merchandise, pharmacy or photo-finishing departments. In addition to marketing to existing customers, we are also starting to run our customer data against external lists to find people living close to our stores that do not shop with us. We can then offer them direct incentives to visit our stores and become new customers.

Another benefit of the cards is they can reduce our promotional expense when we offer attractive item discounts. Because we can electronically monitor the number of sale items sold to a particular customer, we can enforce quantity limits. In this way, we satisfy our loyal customers and at the same time reduce the number of customers who only shop our stores to buy large quantities of sale items. The loyalty card program is an investment in our customers. Providing discounts and winning loyalty contribute toward increasing our average transaction size and strengthening our market share.



"Lucky Sav-on prices are very low - lower than other stores. Their quality is also better and that's why I shop here. Their Rewards card gives me great savings and there are lots of new items every week on special with the card. The ad mailed to my house shows me exactly which items are on a Rewards card discount."

- Tony Perez





## Consolidating the Supply-Chain and Support Structure

During 1997 American Stores completed the consolidation of its procurement and support functions. With the completion of the centralization of the Jewel and Acme buying groups, we began buying from our vendors as one company with one voice. This has enabled us to achieve procurement savings on many items above and beyond the best pricing obtained by any of our divisions functioning independently. This consolidation represents a milestone for American Stores.

We are close to completing the consolidation of four general merchandise warehouses in southern California into one. This is another major accomplishment as it will save significant costs and help to keep inventory at optimal levels. Our trucks from this warehouse will service our stores throughout California, Nevada, Arizona and New Mexico. Through consolidation and new computer systems we are driving our distribution costs lower.

Technology plays a key role in our investment plan for the future. We have been aggressively upgrading systems throughout our organization. We now have common platforms for most applications across all our divisions and are rapidly expanding our decision support capabilities. These systems will allow us to use information quickly and efficiently to make better business decisions.



Today American Stores is working to complete the integration of our supply-chain processes and systems. We have successfully completed many initiatives that will lead us to this ultimate goal. Our entire supply-chain is managed by procurement and distribution teams in our headquarters in Salt Lake City. A central marketing group is also currently organizing. We have eliminated many redundancies in our organization and are working to achieve additional economies of scale. We are convinced now more than ever before that our self-consolidation and extensive re-engineering investments over the past several years have placed us in a position to be more competitive in our industry and will keep our cost structure as low as possible.

For our customers, our supply-chain improvements and efficiencies are manifested in our consistent, high-quality products, our reliable in-stock positions and our low, competitive pricing. Savings that we realize through buying and distribution efficiencies are often given back to our customers in the form of higher quality and lower prices. This keeps our customers satisfied, reinforces their loyalty and strengthens our market share position.

**"I can always count on my Jewel Osco to have the freshest produce, meats and breads. It doesn't matter which day of the week I shop or what time of day it is. The quality of the perishables is consistently high. They carry what I need and never seem to be out of stock."**

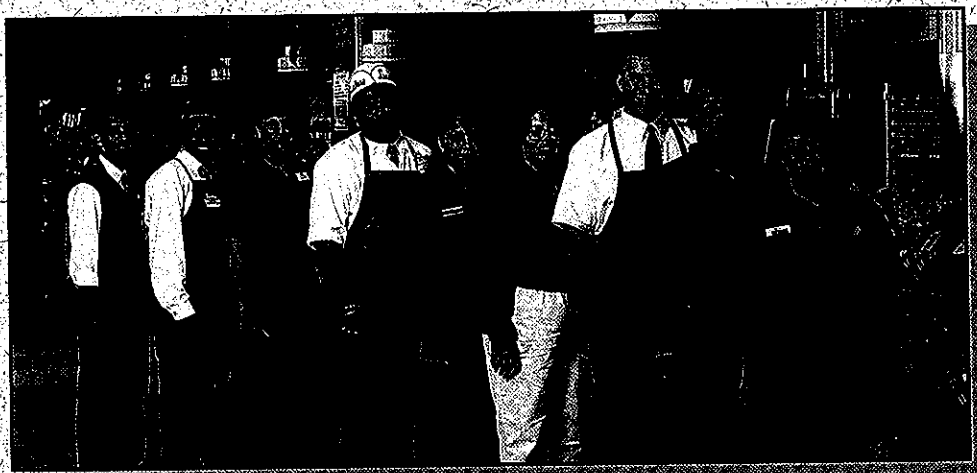
**- George Sourele**





## Strengthening our Associates and Diversity

Our associates at American Stores are an integral part of our success. We take pride in the quality of our associates and are working as a team to take our Company to the next level. We have invested significantly in recruiting, training and mentoring programs. We formed an education department in our Salt Lake City headquarters called "American Stores University." This group of trainers provides broad and in-depth education and development programs to our associates at all levels in areas stretching from store merchandising to technology to associate team building. To nurture a consistent inflow of new talent to the Company, we also offer internships and scholarships through many colleges and universities each year to students of retail management, pharmacy and other disciplines.



Our management and associates have an important stake in American Stores. Combined they own approximately 9% of the outstanding shares of the Company. Our associates, if eligible, may purchase Company stock through an Employee Stock Purchase Plan and through our profit sharing retirement plan. Nearly all Company officers are shareholders and a significant portion of their compensation is tied to the Company's performance.

Managements' interests are squarely aligned with those of all shareholders.



Our twelve-member Board of Directors represents expertise in areas of retailing, law, education, health care, food processing and finance. Nine of the twelve Board members are outsiders and half of their director compensation is in the form of Company stock.

Finally, our Company is committed to keeping a diverse workforce throughout our organization. We are a retailer that serves millions of customers each year and must understand the shopping preferences of our diverse customer base. Our employment policies and practices are based on objectives of equal employment and advancement opportunity.

"The Acme associates are the best. The main reason I shop Acme is because I can always count on the friendly, helpful service. I can tell they enjoy their work and it actually makes shopping for me something I look forward to."

- Mary Coon



# SELECTED FINANCIAL DATA



The following consolidated selected financial data of the Company for the last five fiscal years should be read in conjunction with the consolidated financial statements and related notes appearing on pages 20 to 30 of this report.

Comparisons of operating results between fiscal years 1993 to 1997 are difficult due to the Company's disposition of stores. These include the disposition of 45 Acme Markets stores in the fourth quarter of 1994 and the 33-store Star Market food division in the third quarter of 1994. These disposed of stores generated sales in the amounts of \$.8 billion and \$1.2 billion in 1994 and 1993, respectively. In addition, all years included 52 weeks except for 1995, which included 53 weeks.

(In thousands of dollars, except per share data)(1)	1997	1996	1995 (2)	1994	1993
<b>Sales</b>	<b>\$19,138,880</b>	<b>\$18,678,129</b>	<b>\$18,308,894</b>	<b>\$18,355,126</b>	<b>\$18,763,439</b>
Earnings before extraordinary item	<b>\$280,620</b>	<b>\$287,221</b>	<b>\$316,809</b>	<b>\$345,184</b>	<b>\$262,090</b>
Extraordinary item - early retirement of debt - net of taxes					(15,000)
<b>Net earnings</b>	<b>\$280,620</b>	<b>\$287,221</b>	<b>\$316,809</b>	<b>\$345,184</b>	<b>\$247,090</b>
Basic earnings per share before extraordinary item (3)	<b>\$1.02</b>	<b>\$.98</b>	<b>\$1.08</b>	<b>\$1.21</b>	<b>\$.92</b>
Extraordinary item - early retirement of debt - net of taxes (3)					(.05)
<b>Basic earnings per share (3)</b>	<b>\$1.02 (7)</b>	<b>\$.98 (8)</b>	<b>\$1.08</b>	<b>\$1.21 (9)</b>	<b>\$.87</b>
<b>Diluted earnings per share (3)</b>	<b>\$1.01 (7)</b>	<b>\$.98 (8)</b>	<b>\$1.08</b>	<b>\$1.17 (9)</b>	<b>\$.85</b>
Basic average shares (3)	<b>276,409</b>	<b>291,776</b>	<b>293,887</b>	<b>285,534</b>	<b>284,403</b>
Diluted average shares (3)	<b>277,769</b>	<b>292,651</b>	<b>294,465</b>	<b>301,889</b>	<b>301,190</b>
Cash dividends declared per share	<b>\$.35</b>	<b>\$.32</b>	<b>\$.28</b>	<b>\$.24</b>	<b>\$.20</b>
Total assets	<b>\$8,536,015</b>	<b>\$7,881,405</b>	<b>\$7,362,964</b>	<b>\$7,031,566</b>	<b>\$6,927,434</b>
Total debt and obligations under capital leases	<b>\$3,302,905</b>	<b>\$2,679,147</b>	<b>\$2,240,168</b>	<b>\$2,205,291</b>	<b>\$2,167,999</b>
Total capital expenditures (4)	<b>\$1,157,342</b>	<b>\$1,065,436</b>	<b>\$823,068</b>	<b>\$572,575</b>	<b>\$652,928</b>
Store count (5)	<b>1,557</b>	<b>1,529</b>	<b>1,497</b>	<b>1,448</b>	<b>1,547</b>
Selling area square footage (000's) (6)	<b>35,114</b>	<b>33,823</b>	<b>32,523</b>	<b>31,179</b>	<b>32,727</b>

(1) Restated as necessary to reflect the July 1997 two-for-one stock split

(2) 53-week fiscal year

(3) The earnings per share amounts comply with Statement of Financial Accounting Standards No. 128, Earnings Per Share

(4) Amount includes capitalized leases and the net present value of property, plant and equipment leased under operating leases

(5) Includes jointly operated combination stores counted as one store

(6) Selling area square footage was 74% of total retail square footage in 1997

(7) Includes non-recurring items related to the repurchase of a major shareholder's stock and the sale of a division of the Company's communications subsidiary totaling \$.14 per share of expense

(8) Includes special charges totaling \$.21 per share of expense

(9) Includes non-recurring items totaling \$.19 per share of income

NOTE: The fiscal year of the Company ends on the Saturday nearest to January 31. All references herein to "1997", "1996", "1995", "1994" and "1993" represent the fiscal years ended January 31, 1998, February 1, 1997, February 3, 1996, January 28, 1995 and January 29, 1994, respectively. All years include 52 weeks except for 1995, which included 53 weeks.



## Results of Operations

Comparisons between years are rendered difficult due to the fact that not all fiscal years being compared were the same length; the 1995 fiscal year included 53 weeks while the 1997 and 1996 fiscal years included 52 weeks.

Total sales increased to \$19.1 billion in 1997 from \$18.7 billion in 1996 and \$18.3 billion in 1995. The total sales increase was 2.5% in 1997 and 2.0% in 1996. Adjusting for the extra week in 1995, total sales would have increased 4.0% in 1996. Comparable store sales (sales from stores that have been open at least one year, including replacement stores) increased in 1997, 1996 and 1995 by .9%, 3.3% and 1.4%, respectively. The improvement in total sales in 1997 is primarily due to the increase in net square footage during the year. During 1997 the Company opened 96 stores and closed 68 stores resulting in a net increase of 28 new stores and an increase in retail square footage of 4.2%. Comparable store sales in 1997 were lower than previous years, despite a strong increase in pharmacy department sales, due to food price deflation, increased competitive new store openings and promotional activity. Comparable store sales in 1997 in the pharmacy departments increased 11.5% for the year. The 1996 increase in total and comparable sales was primarily the result of increased capital spending and effective marketing efforts, including customer loyalty cards and targeted marketing promotions. Total and comparable sales in 1996 also increased due to the impact of a nine-day labor dispute in the first quarter of 1995.

Gross profit as a percent of sales was 26.6% in both 1997 and 1996 and 25.9% in 1995. Gross profit in 1997 improved due to lower cost of goods resulting from centralized buying and a more profitable product mix. However, increased competition, additional expenses associated with warehouse consolidations in southern California and increased sales of third-party prescriptions and name-brand drugs, which yield lower margins, offset these improvements. The increase in 1996 gross profit over 1995 is primarily due to benefits realized from centralized procurement, better product mix and lower warehousing costs. Advertising expense also decreased in 1996 due to the shift from newspaper and print advertising to direct mail targeted marketing. These improvements were partially offset by lower pharmacy margins due to a shift from cash to lower margin third-party customers. The annual pre-tax LIFO charge to earnings amounted to \$2.4 million in 1997, \$11.4 million in 1996 and \$12.8 million in 1995.

Beginning in the fourth quarter of 1997, the Company reclassified certain expenses as operating and administrative expense and restructuring and impairment that were previously classified below operating profit. Prior periods have been reclassified to conform to the current year presentation.

Operating and administrative expense as a percent of sales was 22.6% in 1997 and 1996 and 22.1% in 1995. Although the Company made improvements in expense control due to lower insurance costs, lower health and welfare and pension costs and benefits from renegotiating a new in-store banking service, higher fixed costs due to the increased number of new stores offset these improvements. The increase in 1996 over 1995 is primarily due to increased costs associated with new stores, offset in part by lower self-insurance costs, better overall cost control and improved sales. Fiscal 1995 operating and administrative expense benefited from the early termination of a labor contract resulting in the immediate recognition in 1995 of certain health and welfare savings which were being recognized over the life of the old contract.

Restructuring and impairment in 1997 of \$13.4 million related to charges from the sale of a division of the Company's communications subsidiary.

In 1996 the Company recorded special charges aggregating approximately \$100.0 million before taxes, or \$.21 per diluted share, related primarily to its re-engineering initiatives. The initiatives are designed to transform the Company from a holding company to a unified operating company. The special charges are included in cost of merchandise sold (\$10.0 million), operating and administrative expense (\$12.9 million) and restructuring and impairment (\$77.1 million). The components of the charge include: warehouse consolidation costs, administrative office consolidation costs, asset impairment costs, closed store costs and other miscellaneous charges. Cash expenditures are estimated to approximate \$40.0 million of which \$25.3 million was paid through the fourth quarter of 1997. The Company had recorded a charge of \$15.5 million related to termination benefits to be paid to an estimated 445 people. At year-end 1997, the Company estimated that a total of 550 people would be terminated at a cost of \$16.8 million. Severance costs of \$10.7 million were paid in connection with the consolidation and 407 people were terminated. In 1997 the Company continued its plan to close and consolidate its warehouses and offices and sublease unutilized space where possible. The warehouse and office consolidation efforts were originally projected to be completed during 1997. Due to delays, these projects will be completed during 1998.





The following table details the components of the reserve:

(In millions of dollars)	Original Reserve Balance	Activity to Date	Reserve Adjustments	Reserve Balance 1/31/98
Warehouse consolidation	\$ 26.4	\$30.6	\$ 8.0	\$ 3.8
Office consolidation	26.3	5.6	(5.5)	15.2
Asset impairment	26.4	23.9	(2.5)	
Closed store costs	12.9	12.9		
Other	8.0	8.0		
<b>Total</b>	<b>\$100.0</b>	<b>\$81.0</b>		<b>\$19.0</b>

Operating profit increased 15.1% in 1997 and decreased 4.9% in 1996. Total operating profit was 4.0% of sales in 1997, 3.6% of sales in 1996 and 3.8% of sales in 1995. Operating profit excluding restructuring and impairment and special charges was 4.1% of sales in 1997 and 1996 compared to 3.8% of sales in 1995.

Interest expense increased in 1997 due to higher debt levels primarily from the Company's financing of the repurchase of shares from former chairman L.S. Skaggs and related parties in April 1997 (the Repurchase), as well as increased capital expenditures. Increases in 1996 interest expense were primarily due to increased borrowings.

The caption "Shareholder related expense" in 1997 of \$33.9 million includes charges related to the secondary stock offering of shares held by former chairman L.S. Skaggs and related parties (the Secondary Offering).

The Company's effective income tax rates were 46.4% in 1997, 43.1% in 1996 and 42.5% in 1995. The increase in the 1997 effective tax rate is primarily due to the non-deductibility of expenses related to the Secondary Offering. The increase in the 1996 effective tax rate is due to lower earnings caused by the special charges, the impact of goodwill charges and lower tax credits.

The Company's basic earnings per share were \$1.02, \$.98 and \$1.08 in 1997, 1996 and 1995, respectively. Diluted earnings per share amounted to \$1.01, \$.98 and \$1.08 in 1997, 1996 and 1995, respectively. The Company adopted Statement of Financial Accounting Standards No. 128, Earnings per Share, as of year-end 1997. Prior periods have been restated and there was no material affect on the Company's earnings per share.

### Liquidity and Capital Resources

Cash provided by operating activities was \$855.0 million, \$497.8 million and \$609.1 million for 1997, 1996 and 1995, respectively. The 1997 improvement of \$357.3 million was primarily the result of managing vendor payments.

Cash capital expenditures amounted to \$996.3 million in 1997, \$943.1 million in 1996 and \$772.6 million in 1995. Additional capital expenditures represented by the net present value of leases amounted to \$161.1 million in 1997, \$122.4 million in 1996 and \$50.5 million in 1995.

The following table shows store counts for new, remodeled and closed stores:

	Projected 1998	1997	1996	1995
New	75	96	99	87
Remodels	90	65	84	198
Closed	50	68	67	38

Capital expenditures for fiscal 1998, including the net present value of leases, are expected to approximate \$1.0 billion and will be funded through cash flows from operations, credit facilities and other long-term borrowings. The Company has no material commitments for capital other than those related to its capital program.



On April 8, 1997, the Company (i) repurchased 24.4 million shares of its common stock from former chairman L.S. Skaggs and certain Skaggs family members and charitable trusts (the Selling Stockholders) for an aggregate price of \$550 million and (ii) sold 4.6 million shares of common stock for net proceeds of \$95.9 million pursuant to the exercise of an over-allotment option by the underwriters in connection with a public offering of 30.8 million shares by the Selling Stockholders. On April 8, 1997 the Company also recorded non-recurring charges totaling \$33.9 million related to expenses incurred by the Selling Stockholders which were reimbursed by the Company.

On March 28, 1997, the Company increased the capacity of its revolving credit facility to a \$1.5 billion five-year revolving credit facility which expires in 2002, in order to finance the \$550 million repurchase of common stock from the Selling Stockholders and for general corporate purposes. The Company has a \$1.0 billion commercial paper program supported by the \$1.5 billion revolving credit facility and \$330 million of uncommitted bank lines, which are used for overnight and short-term bank borrowings, and \$1.0 billion in availability under a universal shelf registration statement, of which \$500 million has been designated for the Company's Series B Medium Term Note Program. Subsequent to year-end and as of March 31, 1998, the Company had issued \$145 million under the Program. At year-end 1997, the Company had \$512 million of debt outstanding under the credit facility, \$717 million outstanding under the commercial paper program and \$229 million outstanding under uncommitted bank lines, leaving unused committed borrowing capacity of \$42 million. The average annual interest rates applicable to the debt issued under or supported by the revolving credit facility were 5.9% in 1997, 5.7% in 1996 and 6.2% in 1995.

On May 2, 1997, the Company issued \$300 million of debentures consisting of \$100 million of 7.9% debentures due May 1, 2017 and \$200 million of 7.5% debentures due May 1, 2037. The \$200 million, 40-year debentures are redeemable at the option of each of the registered holders on May 1, 2009. Net proceeds were used to refinance short-term variable rate borrowings and for general corporate purposes.

On July 3, 1997, the Company entered into a \$200 million term loan agreement. The underlying notes bear interest at an average rate of 6.3% and mature July 1, 2004. Net proceeds were used to refinance short-term variable rate borrowings and for general corporate purposes.

During 1997 the Company repaid a \$160 million (22 billion yen) loan. The net increase in debt, including capitalized leases, was \$623.8 million and \$439.0 million in 1997 and 1996, respectively. The increases are due to changes in working capital, increased capital spending and repurchases of common stock, including the repurchase of 24.4 million shares from the Selling Stockholders in 1997.

In June of 1996, the Company replaced its existing stock repurchase program with a new repurchase program which authorizes the repurchase of up to four million shares of common stock (not including the repurchase of shares from the Selling Stockholders). There were no repurchases of common stock under the repurchase program during 1997, and as of January 31, 1998, an additional 3.9 million shares remained authorized for repurchase.

Working capital amounted to \$140.4 million at year-end 1997 compared to \$364.8 million at year-end 1996 and \$96.3 million at year-end 1995. Working capital benefited from higher accounts payable at the end of 1997 primarily due to the management of vendor payments at the end of the fiscal year.

The Company's ratio of total debt (debt plus obligations under capital leases) to total capitalization (total debt plus common shareholders' equity) amounted to 58.9%, 51.4% and 48.8% at year-end 1997, 1996 and 1995, respectively.

The Company believes that its cash flows from operations, supplemented by its revolving credit facility, uncommitted credit facilities, other long-term borrowings, availability under a universal shelf registration statement and its ability to refinance debt, will be adequate to meet its presently identifiable cash requirements.

### **Quantitative and Qualitative Disclosures About Market Risk**

The Company's major market risk exposure is changing interest rates. From time to time, the Company hedges against changes in the yield of U.S. Treasury securities used for determining the interest rate on anticipated public debt financing of the Company using treasury lock, swap, or similar agreements, usually in notional amounts less than the total amount of the anticipated debt issue. These hedging transactions are generally in effect for a period estimated to expire concurrent with the anticipated debt issue. The objective of these derivative transactions is to reduce the Company's exposure to changes in interest rates, and each transaction is evaluated periodically by the Company for changes in market value and counterparty credit exposure.



During 1997 the Company entered into a \$300 million five-year LIBOR basket swap and a \$100 million treasury rate lock. The LIBOR basket swap agreement diversifies the indices used to determine the interest rate on a portion of the Company's variable rate debt by providing for payments based on an average of foreign LIBOR indices which are reset every three months and also provides for a maximum interest rate of 8.0%. The Company recognized income of \$.5 million in 1997 related to this swap. The treasury rate lock agreement was entered into for the purpose of hedging the interest rate on a portion of the debt the Company anticipates issuing in 1998 under the universal shelf registration statement. The treasury lock fixed the rate on the 30-year treasury bond at 6.0% and expires March 31, 1998.

During 1996 the Company entered into an interest rate swap agreement with a notional amount of \$200 million for the purpose of hedging the interest rate on a portion of the \$300 million of debentures the Company issued on May 2, 1997 under the Company's previous shelf registration statement. The swap was terminated in connection with the issuance of the debentures, and the Company realized a net gain of \$6.2 million, which is being amortized over the term of the debt as a reduction to interest expense.

On October 14, 1997, the Company prepaid a foreign loan in the principal amount of 22 billion yen (\$160 million U.S.) bearing interest at a yen interest rate of 6.0% and terminated the related interest rate and currency exchange swap agreement that fixed the interest rate and eliminated the risk of currency fluctuations. The Company incurred a net loss of \$.7 million in connection with the prepayment of the loan and termination of the swap agreement.

The Company is exposed to credit losses in the event of nonperformance by the counterparties to its swap agreements. Such counterparties are highly-rated financial institutions and the Company anticipates they will be able to satisfy their obligations under the contracts.

There have been no material changes in the primary risk exposures or management of the risks since the prior year. The Company expects to continue to manage risks in accordance with the current policy.

### Interest Rate Sensitivity

The table below provides information about the Company's derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, including interest rate swaps and debt obligations. For debt obligations, the table presents principal cash flows and related weighted average interest rates by expected maturity dates. For interest rate swaps, the table presents notional amounts and weighted average interest rates by expected (contractual) maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged under the contracts.

(In thousands of dollars)	1998	1999	2000	2001	2002	Thereafter	Total	Fair Value @ 1/31/98
<b>Liabilities</b>								
Long-term debt, including current portion								
Fixed rate	\$81,407	\$34,086	\$154,946	\$25,419	\$271,554	\$1,216,854	\$1,784,266	\$1,932,708
Average interest rate	8.6%	8.8%	7.8%	10.7%	9.4%	7.7%	8.0%	
Variable rate	\$11,000				\$1,446,899		\$1,457,899	\$1,457,899
Average interest rate	5.9%				5.9%		5.9%	
<b>Interest Rate Derivative Financial Instruments Related to Anticipated Long-term Debt Offering</b>								
Interest rate swap								
Pay fixed/Receive variable	\$100,000						\$100,000	\$(644)
Average pay rate	6.0%							
Average receive rate	5.9%							
<b>Interest Rate Derivative Financial Instruments Related to Long-term Debt</b>								
Interest rate and currency swap								
Pay variable (8% cap)/Receive variable					\$300,000		\$300,000	\$(6,704)
Average pay rate					6.5%			
Average receive rate					5.8%			



## **Year 2000**

The efficient operation of the Company's business is dependent in part on its computer software programs and operating systems (collectively, Programs and Systems). These Programs and Systems are used in several key areas of the Company's business including store operations, merchandise purchasing, inventory management, pricing, sales, warehousing, transportation and financial reporting, as well as in various administrative functions. The Company is in the process of updating its Programs and Systems for Year 2000 compliance. The Company has also been communicating with its vendors, financial institutions and others to assess the status of Year 2000 conversion of their systems since the failure to make their systems Year 2000 compliant could have an adverse affect on the Company's operations.

Based on present information, the Company believes that it will be able to achieve such Year 2000 compliance through a combination of modification or replacement of some existing Programs and Systems. The Company expects that the expenses associated with achieving Year 2000 compliance will be approximately \$25 million. The Company has spent approximately \$16.5 million on Year 2000 compliance through March 31, 1998. No assurance can be given that the Company's efforts nor those of its vendors, financial institutions and others who interact with the Company will be successful.

## **Environmental**

The Company has identified environmental contamination at certain of its store, warehouse, office and manufacturing facilities (related to current operations as well as previously disposed of businesses) which are primarily related to underground petroleum storage tanks (USTs) and ground water contamination. The Company conducts an on-going program for the inspection and evaluation of new sites proposed to be acquired by the Company and the remediation/monitoring of contamination at existing and previously owned sites. The Company anticipates that all USTs will be in compliance with 1998 UST upgrade requirements established by the Environmental Protection Agency. Although the ultimate outcome and expense of environmental remediation is uncertain, the Company believes that the required costs of remediation, UST upgrades and continuing compliance with environmental laws will not have a material adverse effect on the financial condition or operating results of the Company.

## **Inflation**

In recent years, the impact of deflation or inflation on the Company's results of operations has been moderate. As operating expenses and inventory costs change, the Company adjusts its retail prices accordingly.

The Company uses the LIFO (last-in, first-out) method of accounting for the majority of its inventories. Under this method, the cost of merchandise sold reported in the financial statements approximates current costs and thus reduces the distortion in reported earnings due to increasing costs.

The historical costs of property, plant and equipment recorded by the Company were incurred over a period of several years. The cost of replacing property, plant and equipment is generally greater than the cost on the books of the Company as a result of inflation that has occurred over the years since the property, plant and equipment were placed in service.

## **Stock Split**

On June 17, 1997, the Board of Directors of the Company declared a two-for-one stock split of the Company's common stock. The split was payable July 16, 1997, to shareholders of record on July 1, 1997. All share and per share information has been restated to reflect the stock split.

## **New Accounting Standard**

Statement No. 131, Disclosure about Segments of an Enterprise and Related Information, was issued by the Financial Accounting Standards Board in June 1997, effective for fiscal years beginning after December 15, 1997. The Company has determined that it will continue to have only one reportable segment.

## **Preferred Share Purchase Rights**

On March 18, 1998, the Preferred Share Purchase Rights issued pursuant to a Rights Agreement, dated March 18, 1988, as amended, expired in accordance with their terms without renewal or extension.



**ERNST & YOUNG LLP**

Shareholders and Board of Directors  
American Stores Company

We have audited the accompanying consolidated balance sheets of American Stores Company and subsidiaries as of January 31, 1998, February 1, 1997 and February 3, 1996, and the related consolidated statements of earnings, shareholders' equity and cash flows for each of the three fiscal years in the period ended January 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of American Stores Company and subsidiaries at January 31, 1998, February 1, 1997 and February 3, 1996, and the consolidated results of their operations and their cash flows for each of the three fiscal years in the period ended January 31, 1998, in conformity with generally accepted accounting principles.

*Ernst + Young LLP*

March 18, 1998  
Salt Lake City, Utah

# CONSOLIDATED STATEMENTS OF EARNINGS



(In thousands, except per share data)	52 weeks 1997	52 weeks 1996	53 weeks 1995
<b>Sales</b>	<b>\$19,138,880</b>	<b>\$18,678,129</b>	<b>\$18,308,894</b>
Cost of merchandise sold, including warehousing and transportation expenses	<u>14,039,263</u>	<u>13,713,151</u>	<u>13,558,690</u>
<b>Gross profit</b>	<b>5,099,617</b>	<b>4,964,978</b>	<b>4,750,204</b>
Operating and administrative expenses	<u>4,317,576</u>	<u>4,220,187</u>	<u>4,048,490</u>
Restructuring and impairment	<u>13,400</u>	<u>77,151</u>	
<b>Operating profit</b>	<b>768,641</b>	<b>667,640</b>	<b>701,714</b>
Other income (expense):			
Interest income	5,647	8,470	8,747
Interest expense	(216,710)	(171,558)	(159,545)
Shareholder related expense	<u>(33,913)</u>		
Total other income (expense)	<u>(244,976)</u>	<u>(163,088)</u>	<u>(150,798)</u>
<b>Earnings before income taxes</b>	<b>523,665</b>	<b>504,552</b>	<b>550,916</b>
Federal and state income taxes	<u>(243,045)</u>	<u>(217,331)</u>	<u>(234,107)</u>
<b>Net earnings</b>	<b>\$ 280,620</b>	<b>\$ 287,221</b>	<b>\$ 316,809</b>
<b>Basic earnings per share</b>	<b><u>\$1.02</u></b>	<b><u>\$ .98</u></b>	<b><u>\$1.08</u></b>
<b>Diluted earnings per share</b>	<b><u>\$1.01</u></b>	<b><u>\$ .98</u></b>	<b><u>\$1.08</u></b>
Average number of common shares outstanding used for basic earnings per share	<b>276,409</b>	<b>291,776</b>	<b>293,887</b>
Dilutive common stock options	<u>1,360</u>	<u>875</u>	<u>578</u>
Average number of common shares outstanding used for dilutive earnings per share	<u><b>277,769</b></u>	<u><b>292,651</b></u>	<u><b>294,465</b></u>
Outstanding employee stock options having no dilutive effect (exercise price \$23.72-\$25.00 per share)	<b>4,350</b>		

See notes to consolidated financial statements

# CONSOLIDATED BALANCE SHEETS



	Year-end		
(In thousands of dollars, except per share data)	1997	1996	1995
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash and cash equivalents	\$ 47,794	\$ 37,467	\$ 102,422
Receivables	399,319	318,878	319,688
Inventories	1,714,229	1,725,542	1,572,242
Prepaid expenses	71,855	66,510	69,098
Deferred income tax benefits	28,583	18,099	20,517
<b>Total Current Assets</b>	<b>2,261,780</b>	<b>2,166,496</b>	<b>2,083,967</b>
<b>Property, Plant and Equipment and Property Under Capital Leases, at cost</b>			
Land	779,873	636,068	597,804
Buildings	2,325,388	1,980,660	1,582,485
Fixtures and equipment	2,877,019	2,616,786	2,415,479
Leasehold improvements	831,364	781,454	736,682
	6,813,644	6,014,968	5,332,450
Less accumulated depreciation and amortization	2,552,723	2,361,255	2,126,550
<b>Net Property, Plant and Equipment</b>	<b>4,260,921</b>	<b>3,653,713</b>	<b>3,205,900</b>
<b>Goodwill, net of accumulated amortization</b>	<b>1,611,812</b>	<b>1,665,242</b>	<b>1,722,892</b>
<b>Other Assets</b>	<b>401,502</b>	<b>395,954</b>	<b>350,205</b>
<b>Total Assets</b>	<b>\$8,536,015</b>	<b>\$7,881,405</b>	<b>\$7,362,964</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current Liabilities</b>			
Accounts payable	\$1,186,845	\$ 851,285	\$ 996,354
Accrued payroll and benefits	301,656	325,806	331,843
Current portion of self-insurance reserves	108,263	121,144	153,464
Income taxes payable	11,293	21,290	17,292
Other current liabilities	412,342	416,153	353,598
Current maturities of long-term debt and obligations under capital leases	100,935	66,003	135,152
<b>Total Current Liabilities</b>	<b>2,121,334</b>	<b>1,801,681</b>	<b>1,987,703</b>
<b>Self-insurance Reserves, less current portion</b>	<b>390,661</b>	<b>403,981</b>	<b>434,028</b>
<b>Deferred Income Taxes</b>	<b>349,041</b>	<b>348,846</b>	<b>365,978</b>
<b>Other Liabilities</b>	<b>163,927</b>	<b>178,326</b>	<b>115,743</b>
<b>Long-term Debt and Obligations Under Capital Leases, less current maturities</b>	<b>3,201,970</b>	<b>2,613,144</b>	<b>2,105,016</b>
<b>Shareholders' Equity</b>			
Common stock of \$1.00 par value, authorized 700,000,000 shares; issued 299,778,472 shares	299,778	299,778	299,778
Additional paid-in capital	269,205	212,672	195,229
Retained earnings	2,320,322	2,136,744	1,942,874
Less cost of treasury stock; 26,171,962 shares in 1997, 7,949,190 shares in 1996 and 6,882,902 shares in 1995	(580,223)	(113,767)	(83,385)
<b>Total Shareholders' Equity</b>	<b>2,309,082</b>	<b>2,535,427</b>	<b>2,354,496</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$8,536,015</b>	<b>\$7,881,405</b>	<b>\$7,362,964</b>

See notes to consolidated financial statements

# CONSOLIDATED STATEMENTS OF CASH FLOWS



(In thousands of dollars)	52 weeks 1997	52 weeks 1996	53 weeks 1995
<b>Cash Flows from Operating Activities:</b>			
Net earnings	\$280,620	\$287,221	\$316,809
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	468,869	440,445	404,562
Net (gain) loss on asset sales	(772)	265	(3,219)
Self-insurance reserves	(26,201)	(62,367)	(56,222)
Other	(100,078)	59,654	(92,688)
(Increase) decrease in current assets:			
Receivables	(80,441)	810	(32,694)
Inventories	11,313	(152,920)	(54,645)
Prepaid expenses	(15,829)	5,006	28,164
Increase (decrease) in current liabilities:			
Accounts payable	335,560	(145,069)	124,750
Other current liabilities	16,137	66,759	23,305
Accrued payroll and benefits	(24,150)	(6,037)	(18,794)
Income taxes payable	(9,997)	3,998	(30,249)
Total adjustments	574,411	210,544	292,270
Net cash provided by operating activities	<u>855,031</u>	<u>497,765</u>	<u>609,079</u>
<b>Cash Flows from Investing Activities:</b>			
Expended for property, plant and equipment	(996,288)	(943,080)	(772,611)
Proceeds from sale of assets	39,447	47,670	50,511
Net cash used in investing activities	<u>(956,841)</u>	<u>(895,410)</u>	<u>(722,100)</u>
<b>Cash Flows from Financing Activities:</b>			
Proceeds from long-term borrowing	500,000	350,000	278,500
Payment of long-term borrowing	(160,000)	(100,000)	(125,000)
Net addition to (reduction of) debt and obligations under capital leases	279,101	188,979	(201)
Proceeds from exercise of stock options, other	44,164	24,860	22,049
Repurchase of common stock		(37,798)	(72,987)
Repurchase of common stock from major shareholder	(550,000)		
Issuance of common stock for over-allotments	95,914		
Cash dividends	(97,042)	(93,351)	(82,607)
Net cash provided by financing activities	<u>112,137</u>	<u>332,690</u>	<u>19,754</u>
Net increase (decrease) in cash and cash equivalents	<u>10,327</u>	<u>(64,955)</u>	<u>(93,267)</u>
<b>Cash and Cash Equivalents:</b>			
Beginning of Year	<u>37,467</u>	<u>102,422</u>	<u>195,689</u>
<b>End of Year</b>	<u>\$ 47,794</u>	<u>\$ 37,467</u>	<u>\$102,422</u>

See notes to consolidated financial statements



# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY



(In thousands of dollars, except per share data)	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Total
<b>Balances at beginning of 1995</b>	<u>\$289,084</u>	<u>\$ 71,876</u>	<u>\$1,708,672</u>	<u>\$ (18,711)</u>	<u>\$2,050,921</u>
Net earnings — 1995 (53 weeks)			316,809		316,809
Issuance of 1,184,286 shares of stock for stock options and awards		914		7,583	8,497
Dividends (\$.28 per share)			(82,607)		(82,607)
Stock Purchase Incentive Plans including issuance of 120,000 shares		3,869		733	4,602
Conversion of convertible notes	10,694	113,868			124,562
Purchase of 248 shares for treasury				(3)	(3)
Stock Repurchase Program 5,045,000 shares				(72,987)	(72,987)
Other		4,702			4,702
<b>Balances at year-end 1995</b>	<u>\$299,778</u>	<u>\$195,229</u>	<u>\$1,942,874</u>	<u>\$ (83,385)</u>	<u>\$2,354,496</u>
Net earnings — 1996 (52 weeks)			287,221		287,221
Issuance of 1,127,328 shares of stock for stock options, awards and Employee Stock Purchase Plan (ESPP)		7,891		7,497	15,388
Dividends (\$.32 per share)			(93,351)		(93,351)
Stock Purchase Incentive Plans		8,856			8,856
Purchase of 13,124 shares for treasury, including ESPP buybacks		(103)		(78)	(181)
Stock Repurchase Program 2,180,000 shares				(37,798)	(37,798)
Other		799		(3)	796
<b>Balances at year-end 1996</b>	<u>\$299,778</u>	<u>\$212,672</u>	<u>\$2,136,744</u>	<u>\$(113,767)</u>	<u>\$2,535,427</u>
Net earnings — 1997 (52 weeks)			280,620		280,620
Issuance of 1,652,397 shares of stock for stock options, awards and Employee Stock Purchase Plan (ESPP)		5,983		24,704	30,687
Shares related to directors' stock compensation plan - 193,000 shares		3,931		86	4,017
Dividends (\$.35 per share)			(97,042)		(97,042)
Stock Purchase Incentive Plans		10,425			10,425
Purchase of 59,183 shares for treasury, including ESPP buybacks				(967)	(967)
Stock Repurchase from major shareholder - 24,444,444 shares				(550,000)	(550,000)
Stock issuance for over-allotments - 4,622,372 shares		36,194		59,721	95,915
<b>Balances at year-end 1997</b>	<u>\$299,778</u>	<u>\$269,205</u>	<u>\$2,320,322</u>	<u>\$(580,223)</u>	<u>\$2,309,082</u>

See notes to consolidated financial statements



## Nature of Operations

American Stores Company is one of the nation's leading food and drug retailers, operating 1,557 stores in 26 states. The Company operates in a single industry segment and its principal formats include supermarkets, stand-alone drug stores and combination food/drug stores. Principal markets include California, Illinois, New Jersey, Pennsylvania, Nevada, Indiana, Massachusetts and Arizona, where products are sold primarily to retail customers.

## Significant Accounting Policies

**Fiscal Year.** The fiscal year of the Company ends on the Saturday nearest to January 31. All references herein to "1997", "1996" and "1995" represent the 52-week fiscal years ended January 31, 1998 and February 1, 1997 and the 53-week fiscal year ended February 3, 1996, respectively.

**Basis of Consolidation.** The consolidated financial statements include the accounts of American Stores Company and all subsidiaries. Accordingly, all references herein to "American Stores Company" include the consolidated results of its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Use of Estimates.** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Cash and Cash Equivalents.** The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair value.

**Depreciation and Amortization.** Depreciation and amortization are provided on a straight-line basis over the estimated useful lives of owned assets. Leasehold improvements and leased properties under capital leases are amortized over the estimated useful life of the property or over the term of the lease, whichever is shorter. The depreciable lives are primarily 20 to 40 years for buildings, 3 to 10 years for fixtures and equipment and 15 to 25 years for leasehold improvements and property under capital lease, depending on the life of the lease. Depreciation expense related to property, plant and equipment amounted to \$390.4 million, \$359.9 million and \$324.5 million in fiscal 1997, 1996 and 1995, respectively. Amortization expense related to property under capital leases amounted to \$8.5 million, \$9.2 million and \$10.4 million in fiscal 1997, 1996 and 1995, respectively.

**Goodwill.** Goodwill, principally from the acquisition of Lucky Stores, Inc. in 1988, represents the excess of cost over fair value of net assets acquired and is being amortized over 40 years using the straight-line method. Accumulated amortization amounted to \$524.6 million, \$471.2 million and \$418.0 million in 1997, 1996 and 1995, respectively.

**Costs of Opening and Closing Stores.** The costs of opening new stores are charged against earnings as incurred. When operations are discontinued and a store is closed, the remaining investment, net of salvage value, is charged against earnings and, for leased stores, a provision is made for the remaining lease liability, net of expected sublease income.

**Derivative Financial Instruments.** The Company enters into treasury locks, interest rate swaps and similar agreements to modify the interest rate characteristics of its outstanding debt or on anticipated public debt financing of the Company and holds them strictly for purposes other than trading. The objective of these derivative transactions is to reduce the Company's exposure to changes in interest rates, and each transaction is evaluated periodically by the Company for changes in market value and counterparty credit exposure.

The agreements are usually in notional amounts less than the total amount of the anticipated debt issue and are generally in effect for a period estimated to expire concurrent with the anticipated debt issue. They involve the exchange of amounts based on a fixed interest rate for amounts based on variable interest rates over the life of the agreement without an exchange of the notional amount upon which the payments are based. The difference to be paid or received as interest rates change is recognized quarterly in the case of the LIBOR basket swap. The fair value of the treasury rate lock is amortized over the term of debt issued. In the event of the early extinguishment of an obligation, any realized or unrealized gain or loss from the swap would be recognized in income coincident with the extinguishment of the obligation.

**Income Taxes.** The Company provides for deferred income taxes or credits as temporary differences arise in recording income and expenses between financial reporting and tax reporting. Amortization of goodwill is not deductible for purposes of calculating income tax provisions.



**Earnings Per Share.** Earnings per share amounts for all periods have been restated to conform to the requirements of Statement of Financial Accounting Standards No. 128, Earnings Per Share. The adoption of Statement No. 128 did not have a material impact on earnings per share.

**Environmental Remediation Costs.** Costs incurred to investigate and remediate contaminated sites are accrued when identified and estimable. The related costs are expensed unless the remediation extends the economic useful life of the assets employed at the site.

**Self-insurance.** The Company is self-insured for property loss, workers' compensation, general liability and automotive liability, subject to specific retention levels. The Company is required in certain cases to obtain letters of credit to support its self-insured status. At year-end 1997, the Company's self-insured liabilities were supported by approximately \$244.6 million of undrawn letters of credit. The Company is also self-insured for health care claims for eligible active and retired associates. Self-insured liabilities, with the exception of postretirement health care benefits, are not discounted.

The basis for the amount of the Company's accrual for self-insurance claims is determined by an independent actuary who arrives at the ultimate costs of claims that have occurred by analyzing amounts already paid to claimants, open case reserves and an estimate of incurred but not reported losses, including both claims that are unreported as of the valuation date and the future growth in claim value that will occur as more information about each claim becomes known.

**Impairment.** Impairment is recognized on long-lived assets when indicators of impairment are present and the undiscounted cash flows are less than the related assets' carrying value.

**Stock-based Compensation.** The Company continues to account for stock-based compensation using the intrinsic value method and provides pro forma footnote disclosure of the impact of the fair value method.

### **New Accounting Standard**

Statement No. 131, Disclosure about Segments of an Enterprise and Related Information, was issued by the Financial Accounting Standards Board in June 1997, effective for fiscal years beginning after December 15, 1997. The Company has determined that it will continue to have only one reportable segment.

### **Inventories**

Approximately 94% of inventories are accounted for using the LIFO (last-in, first-out) method for inventory valuation. If the FIFO (first-in, first-out) and average cost methods had been used, inventories would have been \$327.0 million, \$324.5 million and \$313.1 million higher at year-end 1997, 1996 and 1995, respectively. The LIFO charge to earnings was \$2.4 million in 1997, \$11.4 million in 1996 and \$12.8 million in 1995. Under this method, the cost of merchandise sold that is reported in the financial statements approximates current costs and thus reduces the distortion in reported earnings due to inflation or deflation.

### **Advertising Expense**

The Company expenses advertising costs when the advertisement occurs. Total advertising expense amounted to \$156.2 million, \$133.2 million and \$168.3 million in 1997, 1996 and 1995, respectively. Capitalized advertising costs were \$2.5 million, \$4.0 million and \$3.1 million in 1997, 1996 and 1995, respectively.

### **Reclassification**

The 1996 and 1995 financial statements have been reclassified to conform to the current year presentation.

### **Stock Split**

On June 17, 1997, the Board of Directors of the Company declared a two-for-one split of the Company's common stock. The split was payable July 16, 1997, to shareholders of record on July 1, 1997. All share and per share information has been restated to reflect the stock split.



## Debt

On May 2, 1997, the Company issued \$300 million of debentures consisting of \$100 million of 7.9% debentures due May 1, 2017 and \$200 million of 7.5% debentures due May 1, 2037. The \$200 million, 40-year debentures are redeemable at the option of each of the registered holders on May 1, 2009. Net proceeds were used to refinance short-term variable rate borrowings and for general corporate purposes.

On July 3, 1997, the Company entered into a \$200 million term loan agreement. The underlying notes bear interest at an average rate of 6.3% and mature July 1, 2004. Net proceeds were used to refinance short-term variable rate borrowings and for general corporate purposes.

On March 28, 1997, the Company increased the capacity of its revolving credit facility to a \$1.5 billion five-year revolving credit facility which expires in 2002. This facility was the Company's principal bank credit agreement at year-end 1997. Interest rates for borrowings under the revolving credit facility are established at the time of borrowing through one of four different pricing options. Terms of the revolving credit facility provide for borrowings from participating banks or borrowings through issuance of commercial paper that is supported by the facility. The credit facility, among other customary conditions, provides for a covenant of cash flow to total debt.

The Company also has a \$1.0 billion commercial paper program supported by the \$1.5 billion revolving credit facility, and \$330 million of uncommitted bank lines, which are used for overnight and short-term bank borrowings. At year-end 1997, the Company had \$512 million of debt outstanding under the credit facility, \$717 million outstanding under the commercial paper program and \$229 million outstanding under uncommitted bank lines, leaving unused committed borrowing capacity of \$42 million. The Company has classified short-term borrowings as long-term due to its intent and ability to refinance these borrowings on a long-term basis. On February 3, 1998, the Company's \$1.0 billion universal shelf registration statement became effective, of which \$500 million has been designated for the Company's Series B Medium Term Note Program.

The Company capitalized interest costs associated with construction projects of \$16.2 million, \$10.6 million and \$8.5 million in 1997, 1996 and 1995, respectively. The Company made cash payments for interest (net of amounts capitalized) of \$204.3 million, \$160.8 million and \$169.5 million in 1997, 1996 and 1995, respectively.

The aggregate amounts of debt maturing in each of the next five fiscal years are listed below:

(In thousands of dollars)

1998	\$ 92,407
1999	34,086
2000	154,946
2001	25,419
2002	1,718,453
Thereafter	1,216,854
Total debt	3,242,165
Capital lease obligations	60,740
<b>Total debt and obligations under capital leases</b>	<b>\$3,302,905</b>

The Company's various loans secured by real estate are collateralized by properties with a net book value of \$232.3 million at year-end 1997.





A summary of debt is as follows:

(In thousands of dollars)	1997	1996	1995
<b>Public Debt (unsecured):</b>			
7.5% Debentures due 2037, put option 2009	\$ 200,000		
8.0% Debentures due 2026	350,000	\$ 350,000	
7.9% Debentures due 2017	100,000		
7.4% Notes due 2005	200,000	200,000	\$ 200,000
Medium Term Notes—fixed interest rates due 1998 through 2003— average interest rate 7.9%	200,000	250,000	250,000
9-1/8% Notes due 2002	249,320	249,191	249,075
<b>Bank Borrowings (unsecured):</b>			
Revolving credit facility—variable interest rates, effectively due 2002— average interest rates 5.9% in 1997, 5.7% in 1996 and 6.2% in 1995	512,000	957,000	865,000
Lines of credit and commercial paper— variable interest rates, effectively due 2002—average interest rates 5.9% in 1997, 5.6% in 1996 and 6.4% in 1995	945,899	183,000	69,000
Notes due 2004—average interest rate 6.3%	200,000		
Other borrowings—due 2000—average interest rates 6.6% in 1997 and 1996 and 6.5% in 1995	75,000	75,000	125,000
<b>Other Unsecured Debt:</b>			
9.8% due in 1999		160,000	210,000
10.6% due in 2004	108,893	108,893	108,893
Other—due through 2001	31,505	2,988	3,625
<b>Debt Secured by Real Estate:</b>			
Fixed interest rates—due through 2014— average interest rate 13.4% in 1997, 13.3% in 1996 and 13.3% in 1995	69,548	77,365	83,456
Outstanding debt	3,242,165	2,613,437	2,164,049
Capital lease obligations	60,740	65,710	76,119
Total debt and obligations under capital leases	3,302,905	2,679,147	2,240,168
Less current maturities:			
Debt	92,407	56,703	125,413
Capital lease obligations	8,528	9,300	9,739
Long-term debt and obligations under capital leases	3,201,970	2,613,144	2,105,016
Long-term capital lease obligations	52,212	56,410	66,380
<b>Long-term debt</b>	<b>\$3,149,758</b>	<b>\$2,556,734</b>	<b>\$2,038,636</b>

On October 14, 1997, the Company prepaid a foreign loan in the principal amount of 22 billion yen (\$160 million U.S.) bearing interest at a yen interest rate of 6.0% and terminated the related interest rate and currency exchange swap agreement that fixed the interest rate and eliminated the risk of currency fluctuations. The Company incurred a net loss of \$.7 million in connection with the prepayment of the loan and termination of the swap agreement.

On October 27, 1997, the Company entered into a \$300 million five-year LIBOR basket swap. The agreement diversifies the indices used to determine the interest rate on a portion of the Company's variable rate debt by providing for payments based on foreign LIBOR indices which are reset every three months and also provides for a maximum interest rate of 8.0%. The Company recognized income of \$.5 million in 1997 related to this swap. As of year-end 1997, the estimated fair value of the agreement based on market quotes was a loss of \$6.7 million.

On December 15, 1997, a \$100 million treasury rate lock agreement was entered into for the purpose of hedging the interest rate on a portion of the debt the Company anticipates issuing in 1998 under a universal shelf registration statement. The treasury lock fixed the rate on the 30-year treasury bond at 6.0% and has a term of 3 1/2 months. As of year-end 1997, the estimated fair value of the agreement based on market quotes was a loss of \$.6 million.

During 1996 the Company entered into an interest rate swap agreement with a notional amount of \$200 million, for the purpose of hedging the interest rate on a portion of the \$300 million of debentures the Company issued on May 2, 1997 under the Company's previous shelf registration statement. The swap was terminated in connection with the issuance of the debentures, and the Company realized a net gain of \$6.2 million, which is being amortized over the term of the debt as a reduction to interest expense.



The Company is exposed to credit losses in the event of nonperformance by the counterparties to its swap agreements. Such counterparties are highly-rated financial institutions and the Company anticipates they will be able to satisfy their obligations under the contracts.

The carrying amounts of the Company's bank borrowings with variable interest rates approximate fair value. The fair value of the Company's borrowings with fixed interest rates is estimated using discounted cash flow analyses, based on current market rates where available, or on the Company's current incremental borrowing rates for similar types of borrowing arrangements. The fair value of outstanding debt as of year-end 1997 was \$3.4 billion compared to the carrying value of \$3.2 billion.

### Leases

The Company leases retail stores, offices, warehouses and distribution facilities. Initial lease terms average approximately 20 years, plus renewal options, and may provide for contingent rent based on sales volume in excess of specified levels.

The summary below shows the aggregate future minimum rent commitments at year-end 1997 for both capital and operating leases. Operating leases are shown net of an aggregate \$108.9 million of minimum rent income receivable under non-cancelable subleases. Operating leases also exclude the amortization of acquisition-related fair value adjustments.

(In thousands of dollars)	Operating Leases	Capital Leases
1998	\$ 177,294	\$ 14,693
1999	166,783	13,065
2000	152,054	10,944
2001	139,690	9,617
2002	130,737	8,506
Thereafter	1,140,465	51,012
<b>Total minimum rent commitments</b>	<b><u>\$1,907,023</u></b>	<b><u>107,837</u></b>
Less executory costs (such as taxes, insurance and maintenance) included in capital leases		1,966
Net minimum lease payments		105,871
Less amount representing interest		45,131
<b>Obligations under capital leases, including \$8.5 million due within one year</b>		<b><u>\$ 60,740</u></b>

Additions to obligations under capital leases were \$4.7 million in 1997. Rent expense, excluding the amortization of acquisition-related fair value adjustments of \$13.9 million in 1997, \$14.2 million in 1996 and \$14.3 million in 1995, was as follows:

(In thousands of dollars)	Minimum Rent	Sublease Rent	Net	Contingent Rent	Total Rent
1997	\$206,749	\$17,591	\$189,158	\$22,729	\$211,887
1996	\$189,105	\$15,663	\$173,442	\$24,305	\$197,747
1995	\$180,933	\$14,782	\$166,151	\$26,003	\$192,154

### Income Taxes

Federal and state income taxes charged to earnings are summarized below:

(In thousands of dollars)	52 weeks 1997	52 weeks 1996	53 weeks 1995
<b>Current:</b> Federal	\$214,005	\$206,313	\$124,317
State	23,572	25,731	15,979
<b>Deferred:</b> Federal	4,847	(12,948)	81,859
State	621	(1,765)	11,952
<b>Federal and state income taxes</b>	<b><u>\$243,045</u></b>	<b><u>\$217,331</u></b>	<b><u>\$234,107</u></b>

Cash payments of income taxes were \$263.3 million, \$226.8 million and \$169.2 million in 1997, 1996 and 1995, respectively.



The Company's effective income tax rate differs from the statutory federal income tax rate as follows:

(Percent of earnings before income taxes)	52 weeks 1997	52 weeks 1996	53 weeks 1995
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income tax rate, net of federal income tax effect	4.9	4.8	5.1
Goodwill amortization	4.0	4.2	3.8
Expenses for repurchase of major shareholders' common stock	2.3		
Tax credits	(0.1)	(0.1)	(0.4)
Other	0.3	(0.8)	(1.0)
<b>Effective income tax rate</b>	<b>46.4%</b>	<b>43.1%</b>	<b>42.5%</b>

Deferred tax benefits and liabilities as of year-end 1997 related to the following temporary differences:

(In thousands of dollars)	Benefits	Liabilities	Total
Basis in fixed assets	\$ 29,649	\$(251,607)	<b>\$(221,958)</b>
Self-insurance reserves	159,095		<b>159,095</b>
Purchase accounting valuation	31,436	(285,964)	<b>(254,528)</b>
Compensation and benefits	39,172	(31,109)	<b>8,063</b>
Other, net	104,606	(115,736)	<b>(11,130)</b>
<b>Deferred tax benefits and liabilities</b>	<b>\$363,958</b>	<b>\$(684,416)</b>	<b>\$(320,458)</b>

No valuation allowances have been considered necessary in the calculation of deferred tax benefits.

## Stock Compensation Plans

### Fixed Stock Option Plans

The Company's Stock Option and Stock Awards Plans (Plans) provide for the grant of options to purchase shares of common stock and the issuance of restricted stock awards, subject to certain antidilution adjustments. At year-end 1997, there were 6.4 million shares reserved for future grants or awards under the Company's Plans.

A summary of the Company's stock option activity and related information for 1997, 1996 and 1995 follows:

(Options in thousands)	1997		1996		1995	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	6,030	\$14.36	3,840	\$11.37	2,721	\$ 5.62
Granted	13,210	\$23.14	2,712	\$17.91	3,097	\$12.20
Exercised	(436)	\$11.34	(269)	\$ 8.70	(1,652)	\$ 3.64
Forfeited / Expired	(536)	\$18.21	(253)	\$13.00	(326)	\$10.50
<b>Outstanding at end of year</b>	<b>18,268</b>	<b>\$20.67</b>	<b>6,030</b>	<b>\$14.36</b>	<b>3,840</b>	<b>\$11.37</b>
<b>Exercisable at end of year</b>	<b>1,056</b>		<b>424</b>		<b>473</b>	
<b>Reserved for future grants</b>	<b>6,061</b>		<b>3,596</b>		<b>6,234</b>	

At year-end 1997, there were stock options for 18.3 million shares outstanding which expire through 2007. Exercise prices for outstanding options as of year-end 1997 ranged from \$6.84 to \$24.88 and the weighted-average remaining contractual life of those options is 7.2 years. Compensation expense related to other options decreased pre-tax earnings by \$3.4 million in 1995.



### **Employee Stock Purchase Plan**

The Company's Employee Stock Purchase Plan (ESPP), which began January 1, 1996 enables eligible employees of the Company to subscribe for shares of common stock on quarterly offering dates at a purchase price which is the lesser of 85% of the fair market value of the shares on the first day or the last day of the quarterly offering period. For financial reporting purposes, the discount of 15% is treated as equivalent to the cost of issuing stock. During 1997 employees contributed \$17.2 million to the ESPP program and .9 million shares were issued. Since the ESPP's inception, employees have contributed \$30.8 million and 1.9 million shares have been issued. At year-end 1997, 12.1 million shares were available for future issuances.

### **Long Term Incentive Plans**

During 1997 the Company modified the Long Term Incentive Plans for 1995-1997 and 1996-1998 to provide participants with the option to receive shares of restricted stock in lieu of cash as originally provided. The number of shares issued to participants electing to receive shares of stock was based on the projected value of the Plan pay-out and 282,016 shares were issued on July 1, 1997. Vesting takes place over the original Plan vesting periods; the 1995-1997 Plan vests in April 1998 and the 1996-1998 Plan vests in April 1999.

### **Performance Incentive Program**

During 1997 the Company established the 1997 Performance Incentive Program which would provide certain of the Company's key executives an incentive award of shares of two-year restricted stock if certain Company performance objectives were attained for the 1997 fiscal year. This Program replaced the Long Term Incentive Plans. The Company did not achieve the minimum performance objectives, thus no such shares were issued under the Program.

### **Key Executive Equity Program**

In 1997 the Company established the Key Executive Equity Program (KEEP), a stock-based management incentive program. The new Program continues to link executive incentive compensation to shareholder return. A total of approximately 13.2 million stock options were granted to 165 of the Company's officers in connection with the incentive Program with an exercise price of \$22.50 to \$23.72 per share. The Program involves the grant of market-priced stock options that would ordinarily begin to vest on the fifth anniversary of the grant date but which will vest on an accelerated basis with respect to one-half of the grant if minimum stock ownership requirements are satisfied, and with respect to the other half of the grant if the ownership requirements are met and the Company achieves annual performance goals. During 1997 the performance goal was not achieved, and therefore the options subject to accelerated vesting based on performance during 1997, will not vest until February 24, 2002, the fifth anniversary of the grant date.

To assist the KEEP participants in meeting the stock ownership requirement, the Company issued full recourse interest bearing purchase loans to 18 participants to acquire additional shares of the Company's stock. The stock purchased by the participants was purchased on the open market. The purchase loans have a maturity date of April 1, 2002 and accrue interest at 8.5%, reset annually at the then current prime rate. Outstanding loan balances at year-end 1997 totaled \$2.2 million.

### **Stock Plan for Non-Employee Directors**

During 1997 the shareholders approved the 1997 Stock Plan for Non-Employee Directors (Directors Plan), which provides for: 1) the grant of 2,000 shares annually of the Company's Common Stock (Retainer Stock), 2) the grant on an annual basis of stock options to acquire 1,200 shares of common stock to each participant who satisfies the Minimum Stock Ownership Requirement, and 3) the one time issuance of common stock (173,000 shares in total) to compensate such directors for their respective interests in the Non-Employee Directors' Retirement Plan (Retirement Stock), which was terminated concurrently with the adoption of the Directors' Plan.

The options vest over a two-year period and have a term of 10 years. Retainer Stock vests on the date of the next annual shareholders' meeting. Retirement Stock (and dividends thereon which are reinvested in stock) will be delivered to a participant on the earlier of: 1) death of Participant, 2) change of control or, 3) the later of the date the Participant attains age 65 or the date the Participant ceases to serve as a Director. Directors may elect to defer delivery of Retainer Stock, Retirement Stock and dividends thereon. Compensation expense related to the Retirement Stock and Retainer Stock decreased pre-tax earnings by \$4.0 million in 1997. The options were issued at market value on the date of grant and thus no compensation expense was recognized.



## Fair Value Disclosures

The Company's pro forma compensation expense under the fair value method, utilizing the Black-Scholes option valuation model, for fixed stock options granted in 1997, 1996 and 1995 and for the ESPP in 1997 and 1996, after income taxes, was \$12.9 million for 1997, \$4.8 million for 1996 and \$.8 million for 1995. Pro forma net income would have been \$267.7 million in 1997, \$282.5 million in 1996 and \$316.0 million in 1995. Diluted earnings per share would have been \$.97 for 1997, \$.97 for 1996 and \$1.07 for 1995.

The fair value of options was estimated at the date of grant assuming an average expected volatility of 21.2% and dividend yield of 1.8%. Other assumptions for 1997, 1996 and 1995 are as follows:

	1997	1997 ESPP	1996	1996 ESPP	1995
Average risk-free interest rate	6.6%	5.0 %	6.1%	5.1 %	6.8%
Average life of options (years)	7.0	.25	4.0	.25	5.0
Average vesting date (years)	5.0	2.0	3.0	2.0	5.0

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of fair value of its employee stock options.

Because the fair value method of accounting for stock-based compensation has not been applied to options granted prior to January 1, 1995, the preceding pro forma compensation cost may not be representative of that to be expected in future years.

## Stock Purchase Incentive Plans

In 1992 the Company's shareholders approved both the American Stores Company Key Executive Stock Purchase Incentive Plan and the American Stores Company Board of Directors Stock Purchase Incentive Plan (Plans).

The Company awarded to certain directors and key executive officers the right to purchase a specified number of shares of the Company's stock and extended to such directors and officers full recourse interest bearing, 8-year loans to acquire the stock.

During fiscal 1997, the performance cycle for participants in the Director's Plan and 15 of the 18 participants in the Executive Plan ended and each received a deferred award, which was applied toward repayment of their loans. The balance of the loans, together with accrued and unpaid interest thereon, is payable in three equal installments on the sixth, seventh and eighth anniversaries of the purchase date. The aggregate principal of these loans outstanding is recorded as Other Assets in the balance sheet and as of January 31, 1998, the aggregate outstanding balance (including accrued and unpaid interest) was \$13.6 million.

## Preferred Share Purchase Rights

On March 18, 1998, the Preferred Share Purchase Rights issued pursuant to a Rights Agreement dated March 18, 1988, as amended, expired in accordance with their terms without renewal or extension.

## Repurchase of Common Stock

On April 8, 1997, the Company (i) repurchased 24.4 million shares of its common stock from former chairman L.S. Skaggs and certain Skaggs family members and charitable trusts (the Selling Stockholders) for an aggregate price of \$550 million and (ii) sold 4.6 million shares of common stock for net proceeds of \$95.9 million pursuant to the exercise of an over-allotment option by the underwriters in connection with a public offering of 30.8 million shares by the Selling Stockholders.

In June 1996 the Company replaced its existing stock repurchase program with a new repurchase program which authorizes the repurchase of up to four million shares of common stock (not including the repurchase of shares from the Selling Stockholders). There were no repurchases of common stock under the repurchase program during 1997, and as of January 31, 1998, an additional 3.9 million shares remained authorized for repurchase.



## Postretirement Health Care Benefits

The Company provides certain health care benefits to eligible retirees of certain defined employee groups under two unfunded plans, a defined dollar and a full coverage plan.

The accumulated postretirement health care benefit obligation is as follows:

(In thousands of dollars)	1997	1996	1995
Current retirees	\$35,389	\$38,107	\$37,396
Current active employees	18,640	14,776	14,275
Unrecognized gain	12,058	12,969	14,390
<b>Accumulated postretirement benefit obligation (APBO)</b>	<b>\$66,087</b>	<b>\$65,852</b>	<b>\$66,061</b>
Discount rate	7.5%	7.5%	8.5%

The components of postretirement health care benefit expense are as follows:

(In thousands of dollars)	52 weeks 1997	52 weeks 1996	53 weeks 1995
Service cost - benefits earned during the year	\$ 917	\$ 671	\$ 768
Interest cost on APBO	3,816	3,896	4,006
Adjustment of APBO	(480)	(789)	(465)
<b>Net postretirement health care benefit expense</b>	<b>\$4,253</b>	<b>\$3,778</b>	<b>\$4,309</b>

The Company assumed no increase in the cost of the defined dollar benefit plan in any year presented. Changes in assumptions do not impact the defined dollar plan. The assumed health care cost trend rates used to measure the expected cost of benefits included a rate of increase of 9% for 1998 decreasing to 6% by the year 2000. Increasing the assumed health care cost trend rates for the full coverage plan by one percentage point in each year would have resulted in an increase of \$2.6 million in the APBO and no material increase in annual health care expense.

## Retirement Plans

The Company sponsors and contributes to a defined contribution retirement plan, American Stores Retirement Estates (ASRE). This plan was authorized by the Board of Directors for the purpose of providing retirement benefits for associates of American Stores Company and its subsidiaries. The plan covers associates meeting age and service eligibility requirements, except those represented by a labor union, unless the collective bargaining agreement provides for participation. Contributions to ASRE are made at the discretion of the Board of Directors.

The Company also contributes to multi-employer defined benefit retirement plans in accordance with the provisions of the various labor contracts that govern the plans. The multi-employer plan contributions are generally based on the number of hours worked. Information about these plans as to vested and non-vested accumulated benefits and net assets available for benefits is not available.

During 1994 the Company entered into Employment Agreements (Agreements) with 15 of the Company's key executive officers. The Agreements, as amended, expire on October 31, 2002 and are automatically renewed for subsequent one-year terms, unless terminated by the Company at least two years prior to the end of the term. The Agreements contain usual and customary terms of employment agreements and provide the officers with a special long-range retirement plan. Under the retirement plan, the executives are entitled to receive an annual payment for a period of 20 years beginning at age 57 or upon termination of employment, whichever occurs later. The retirement benefit is calculated as a percentage of the executive's average target compensation objective during the last two years of his or her employment under the Agreement. The benefit ranges from 9% to 40% based on years of service with the Company. The retirement benefit will be forfeited if the executive enters into competition with the Company.

The Company also entered into an employment agreement with a key executive officer in 1994 which, as amended, expires on October 31, 2002, and is automatically renewed for subsequent two-year terms unless terminated by the Company at least three years prior to the end of the term. The agreement provides for an annual retirement benefit that vests over an eight-year period which, if fully vested, would equal \$700,000 adjusted for inflation. Payments will be made over the life of the executive and his spouse. The retirement benefit will be forfeited if the executive enters into competition with the Company.





Retirement plans expense was as follows:

(In thousands of dollars)	52 weeks 1997	52 weeks 1996	53 weeks 1995
Company sponsored plans	\$ 93,342	\$ 88,106	\$ 81,704
Multi-employer plans	71,938	95,822	86,723
<b>Retirement plans expense</b>	<b>\$165,280</b>	<b>\$183,928</b>	<b>\$168,427</b>

### Restructuring and Impairment

Restructuring and impairment in 1997 of \$13.4 million related to charges from the sale of a division of the Company's communications subsidiary.

In 1996 the Company recorded special charges aggregating approximately \$100.0 million before taxes, or \$.21 per diluted share, related primarily to its re-engineering initiatives. The initiatives are designed to transform the Company from a holding company to a unified operating company. The special charges are included in cost of merchandise sold (\$10.0 million), operating and administrative expense (\$12.9 million) and restructuring and impairment (\$77.1 million). The components of the charge include: warehouse consolidation costs, administrative office consolidation costs, asset impairment costs, closed store costs and other miscellaneous charges. Cash expenditures are estimated to approximate \$40.0 million of which \$25.3 million was paid through the fourth quarter of 1997. During the fourth quarter 1996, consolidation of human resources, payroll, Drug Store administration and general merchandise buying functions were announced and the related costs were measurable and recognized. The Company had recorded a charge of \$15.5 million related to termination benefits to be paid to an estimated 445 people. At year-end 1997, the Company estimated that a total of 550 people would be terminated at a cost of \$16.8 million. Severance costs of \$10.7 million were paid in connection with the consolidation and 407 people were terminated. In 1997 the Company continued its plan to close and consolidate its warehouses and offices and sublease unutilized space where possible. The warehouse and office consolidation efforts were originally projected to be completed during 1997. Due to delays, these projects will be completed during 1998.

The following table details the components of the reserve:

(In millions of dollars)	Original Reserve Balance	Activity to Date	Reserve Adjustments	Reserve Balance 1/31/98
Warehouse consolidation	\$ 26.4	\$30.6	\$ 8.0	\$ 3.8
Office consolidation	26.3	5.6	(5.5)	15.2
Asset impairment	26.4	23.9	(2.5)	
Closed store costs	12.9	12.9		
Other	8.0	8.0		
<b>Total</b>	<b>\$100.0</b>	<b>\$81.0</b>		<b>\$19.0</b>

**Environmental**

The Company has identified environmental contamination sites related primarily to underground petroleum storage tanks and ground water contamination at various store, warehouse, office and manufacturing facilities (related to current operations as well as previously disposed of businesses). The Company conducts an on-going program for the inspection and evaluation of new sites proposed to be acquired by the Company and the remediation/monitoring of contamination at existing and previously owned sites. Undiscounted reserves have been established for each environmental contamination site unless an unfavorable outcome is remote. Although the ultimate outcome and expense of environmental remediation is uncertain, the Company believes that required remediation and continuing compliance with environmental laws, in excess of current reserves, will not have a material adverse effect on the financial condition or results of operations of the Company. Charges against earnings for environmental remediation were not material in 1997, 1996 or 1995.

**Legal Proceedings**

The Company is involved in various claims, administrative proceedings and other legal proceedings which arise from time to time in connection with the conduct of the Company's business. In the opinion of management, such proceedings will not have a material adverse effect on the Company's financial condition or results of operations.

# QUARTERLY RESULTS (unaudited)



In the opinion of management, all adjustments necessary for a fair presentation have been included:

(In thousands of dollars, except per share data)(1)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter (5)	Fiscal Year
<b>1997 (2)</b>					
Sales	\$4,747,644	\$4,763,174	\$4,647,465	\$4,980,597	\$19,138,880
Gross profit	1,250,805	1,286,449	1,234,699	1,327,664	5,099,617
Operating profit (6)	167,531	212,420	161,468	227,222	768,641
Other (6)	(33,169)	2,109	1,256	1,538	(28,266)
Net earnings	34,225	89,957	60,275	96,163	280,620
Basic earnings per share (7)	\$.12	\$.33	\$.22	\$.35	\$1.02
Diluted earnings per share (7)	.12	.33	.22	.35	1.01
<b>1996 (3)</b>					
Sales	\$4,580,028	\$4,625,066	\$4,563,362	\$4,909,673	\$18,678,129
Gross profit	1,195,176	1,226,328	1,216,966	1,326,508	4,964,978
Operating profit (6)	149,376	185,195	173,985	159,084	667,640
Other (6)	1,691	1,296	2,027	3,456	8,470
Net earnings	64,240	83,129	75,757	64,095	287,221
Basic earnings per share (7)	\$.22	\$.28	\$.26	\$.22	\$.98
Diluted earnings per share (7)	.22	.28	.26	.22	.98
<b>1995 (4)</b>					
Sales	\$4,362,237	\$4,494,890	\$4,361,183	\$5,090,584	\$18,308,894
Gross profit	1,120,869	1,150,890	1,145,142	1,333,303	4,750,204
Operating profit (6)	130,873	166,319	153,914	250,608	701,714
Other (6)	2,851	2,146	2,153	1,597	8,747
Net earnings	53,883	73,937	67,445	121,544	316,809
Basic earnings per share (7)	\$.18	\$.25	\$.23	\$.42	\$1.08
Diluted earnings per share (7)	.18	.25	.23	.41	1.08

- (1) Restated as necessary to reflect the July 1997 two-for-one stock split
- (2) First quarter 1997 "Other" included charges of \$33.9 million related to the sale of stock by a major shareholder and first quarter 1997 operating profit included charges of \$13.4 million related to the sale of a division of the Company's communications subsidiary (total of \$.14 per share).
- (3) Fourth quarter 1996 includes special charges totaling \$100.0 million pre-tax (\$.21 per share, after tax) in operating profit, including \$10.0 million in gross profit.
- (4) 53-week fiscal year and 14-week fourth quarter, compared to 52-week years and 13-week quarters for fiscal 1997 and 1996.
- (5) Operating profit, before special charges, in the fourth quarter has exceeded the prior three quarters in each of the three years presented due to the seasonality of the food and drug retail business and LIFO inventory adjustments. The holiday and the cold and flu season in the fourth quarter benefits the food and drug retail business.
- (6) Beginning in the fourth quarter of 1997, the Company classified certain expenses as operating and administrative expense and restructuring and impairment that were previously classified below operating profit. Prior years and the first three quarters of 1997 have been reclassified to conform to the current year presentation.
- (7) The 1995, 1996 and first three quarters of 1997 earnings per share amounts have been restated to comply with Statement of Financial Accounting Standards No. 128, Earnings Per Share.

**Board of Directors**

Pamela G. Bailey<sup>1</sup>  
Chief Executive Officer, Healthcare  
Leadership Council

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Arden B. Engebretsen<sup>1,2</sup>  
Chairman of the Board,  
Herpak Limited; Attorney

James B. Fisher<sup>2,3</sup>  
Retired, Former President,  
J.G. Boswell Company

Fernando R. Gumucio<sup>1,2</sup>  
Retired, Former Chairman  
and Chief Executive Officer,  
Del Monte USA

Leon G. Harmon<sup>2,3</sup>  
Retired, Former President  
and Chief Executive Officer,  
First Interstate Bank of Utah, N.A.

Victor L. Lund  
Chairman of the Board and  
Chief Executive Officer

David L. Maher  
Vice Chairman of the Board and  
Chief Operating Officer

John E. Masline<sup>1,2</sup>  
Retired, Former Partner, Ernst & Young

Barbara S. Preiskel<sup>2,3</sup>  
Retired, Attorney

J.L. Scott<sup>1,3</sup>  
Retired, Former President and  
Chief Executive Officer

Arthur K. Smith<sup>1,3</sup>  
Chancellor, University of Houston System

**Officers**

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Chairman of the Board and  
Chief Executive Officer

David L. Maher  
Vice Chairman of the Board  
and Chief Operating Officer

Teresa Beck  
President

Kent T. Anderson  
Chief Operating Officer -  
Strategy and Development

James R. Clark  
Chief Planning Officer

Stephen L. Mannschreck  
Chief Human Resources Officer

Kathleen E. McDermott  
Chief Legal Officer and Assistant Secretary

Edward J. McManus  
Chief Operating Officer -  
Procurement & Logistics

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Chief Labor Officer

Neal J. Rider  
Chief Financial Officer

Martin A. Scholtens  
Chief Operating Officer - Retail

Romeo R. Cefalo  
Executive Vice President and General  
Manager - Lucky Stores Southern  
California Division

James C. Horn  
Executive Vice President and General  
Manager - Acme Markets

Gregory P. Josefowicz  
Executive Vice President and General  
Manager - Jewel Food Stores

Donald C. Keppta  
Executive Vice President and General  
Manager - Lucky Stores Northern  
California Division

Kevin H. Tripp  
Executive Vice President and General  
Manager - American Drug Stores

Allen M. Zietz  
Executive Vice President, Marketing

Scott Bergeson  
Senior Vice President, Human  
Resources

Thomas E. Maddox  
Senior Vice President and Deputy  
General Counsel

Lawrence E. Metz  
Senior Vice President and Deputy  
General Counsel

J. Greg Spencer  
Senior Vice President, Treasurer  
and Assistant Secretary

Bradley M. Vierig  
Senior Vice President and Controller

Stanley R. Whitcomb  
Senior Vice President, Information  
Technology

Mary V. Sloan  
Vice President and Secretary

<sup>1</sup> Audit Committee

<sup>2</sup> Compensation and Stock Option Committee

<sup>3</sup> Nominating and Board Affairs Committee

**PRINCIPAL OPERATING COMPANIES**

The retail operations and non-retail subsidiaries are listed below:

RETAIL OPERATIONS		NON - RETAIL SUBSIDIARIES	
Acme Markets, Inc. 75 Valley Stream Parkway Malvern, Pennsylvania 19355 (610) 889-4000	Lucky Stores Northern California Division 1701 Marina Boulevard San Leandro, California 94577 (510) 678-4200	American Drug Stores, Inc. Osco Drug and Sav-on 299 South Main Street Salt Lake City, Utah 84111 (801) 961-5600	American Stores Properties, Inc. 299 South Main Street Salt Lake City, Utah 84111 (801) 961-5600
Jewel Food Stores, Inc. 1955 West North Avenue Melrose Park, Illinois 60160 (708) 531-6000	Lucky Stores Southern California Division 6565 Knott Avenue Buena Park, California 90620 (714) 739-2200	JOINT VENTURE (50% ownership) RxAmerica, LLC 369 Billy Mitchell Way Salt Lake City, Utah 84116 (801) 961-6000	American Procurement and Logistics Company 299 South Main Street Salt Lake City, Utah 84111 (801) 961-5600

The following information is provided to assist shareholders in their communications with the Company:

**SHAREHOLDER INQUIRIES**

Shareholder inquiries should be directed to:

Investor Relations Department

American Stores Company Telephone: (801) 539-0112  
299 South Main Street (800) 541-2863  
Salt Lake City, Utah 84111-2203 Telefax: (801) 531-0768

**TRANSFER AGENT, REGISTRAR AND DIVIDEND  
PAYING AGENT**

The transfer agent, registrar and dividend paying agent for American Stores Company common stock is First Chicago Trust Company of New York. In this capacity, First Chicago maintains all shareholder records for the corporation. For information about American Stores Company shareholder records or to request replacement of lost dividend checks or stock certificates, shareholders should contact:

First Chicago Trust Company of New York  
P.O. Box 2500  
Jersey City, New Jersey 07303-2500  
(800) 446-2617

**STOCK TRADING**

American Stores Company's common stock is listed on the New York, Philadelphia, Chicago and Pacific stock exchanges, and is quoted in the daily stock tables carried by most newspapers. The ticker symbol for the common stock is "ASC." The stock table abbreviation is "AmStor."

**INTERNET**

Please visit our website at [www.americanstores.com](http://www.americanstores.com).

**FORM 10-K AND QUARTERLY FINANCIAL REPORTS**

Copies of the Company's annual report on Form 10-K may be obtained without charge upon request to the Investor Relations Department.

In lieu of printing and distributing Quarterly Reports to Shareholders, American Stores Company makes available to its shareholders without charge, copies of the Company's quarterly reports on Form 10-Q. Shareholders wishing to receive the Company's Form 10-Q may contact the Investor Relations Department.

**FACT BOOK**

A comprehensive Fact Book with detailed historical financial information is available upon request without charge. It may be obtained by contacting the Investor Relations Department.

**ANNUAL MEETING OF SHAREHOLDERS**

The Annual Meeting of Shareholders will be held on Wednesday, June 17, 1998, at 10:00 a.m. (Mountain Daylight Time) at the Doubletree Hotel, 255 South West Temple, Salt Lake City, Utah.

**1998 CALENDAR**

	Quarter End
First Quarter	May 2, 1998
Second Quarter	August 1, 1998
Third Quarter	October 31, 1998
Fourth Quarter	January 30, 1999





**AMERICAN STORES COMPANY**

299 South Main Street  
Salt Lake City, Utah  
84111-2203



[www.americanstores.com](http://www.americanstores.com)